nikko am
Nikko Asset Management

Factsheet 30 June 2019

NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail)

Market Overview

- Global interest rates trended lower as trade tensions reduced growth outlook.
- NZ short term and long term interest rates continue to move lower.
- The Federal Reserve Chairman Powell said the downside risks to the US economy have increased recently, reinforcing the case for lower rates.
- Equities in the US initially increased after Powell's comment and the yield on 10-year Treasury bonds fell under 2%.

Fund Highlights

- NZ bonds continued to deliver strong returns as interest rates fell.
- The Option Fund lost value over the month. Interest rates continued to fall as financial markets priced in rate cuts from the Federal Reserve over 2019.

Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	-0.81%	0.55%	3.26%	3.73%	5.44%	6.93%
Benchmark[2]	0.59%	1.72%	6.70%	4.47%	6.65%	8.31%

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any)
2. Current benchmark: Composite of (from 1 July 2016) of 70% Bloomberg NZBond Credit 0+ Yr Index and 30% Bloomberg NZ Bond Bank Bill Index plus 4%pa. No tax or fees.

Portfolio Manager

Fergus McDonald,

Head of Bonds and Currency

Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

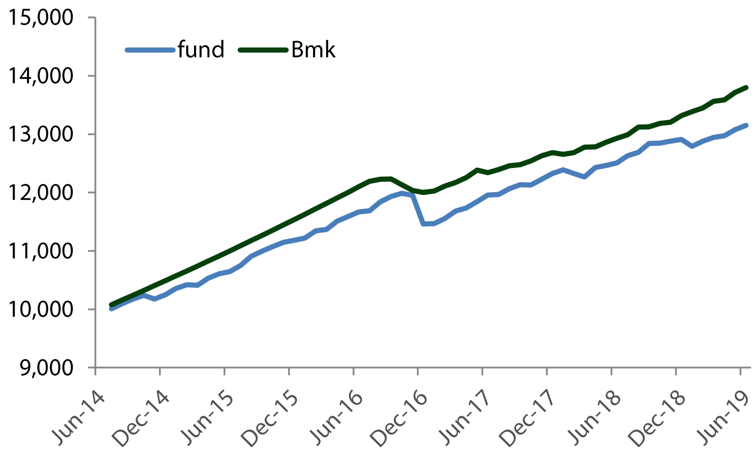
Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio while protecting the capital value of investors' funds.

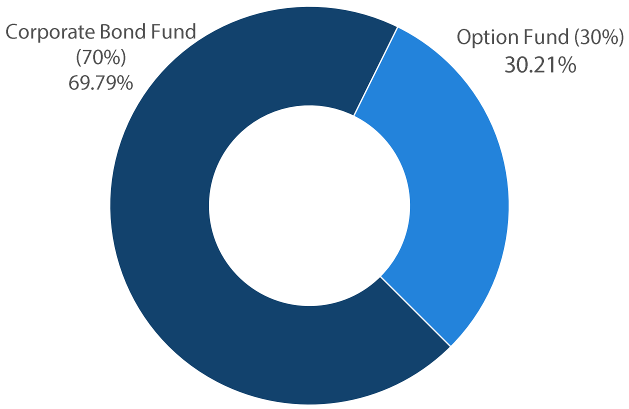
Objective

The aim is to construct a portfolio that earns a return of 6.5% per annum over a rolling three year period before fees, expenses and taxes.

Five Year Cumulative Performance, $10,000 invested[1,2]



Asset Allocation



Top 5 Corporate Issuers*	(%)
Westpac New Zealand	13.37
ASB New Zealand	11.16
Kiwibank	7.40
Bank of New Zealand	6.79
ANZ Bank New Zealand	5.34

*Aggregation of Option and Corporate Bond Funds

Credit Quality*	(%)
AAA	1.52
AA	52.41
A	22.79
BBB	19.08
Collateral & options & NR	4.20

Yield – Corporate Bond Fund
Fund (gross) 2.58% vs Benchmark 2.17%

Option Fund Commentary

Federal Reserve (Fed) Chairman Jerome Powell said the downside risks to the US economy have increased, reinforcing the case amongst policy makers for somewhat lower rates. Cross-currents have re-emerged, with apparent progress on trade turning to greater uncertainty with incoming data raising concerns about the strength of the global economy. US companies seem to have recently become more concerned about the impact of trade tensions on their businesses and this is impacting the pace of business investment. Inflation continues to be muted, the Fed seems to be of the view that lower rates would support economic activity, which would help to raise inflation and inflation expectations. The Fed has failed to convincingly hit its 2% inflation objective since 2012. In addition to this, inflation expectations have fallen and recently the Fed downgraded their forecast of price rises for 2019 to 1.5% from 1.8% in March.

Meanwhile, the US economy is showing signs of slowing after a stronger than expected first quarter. Sales of new homes fell to a five month low in May while consumer confidence dropped in June to its lowest levels since September 2017. On the positive side unemployment remains near record lows. With short term interest rates more likely to fall than rise the extent of any increase in longer term rates is also diminished. If current levels of volatility are maintained, income generated by the fund should remain at satisfactory levels however the speed and magnitude of yield changes in the US 10-year Treasury bond will continue to determine the total return of the fund in the months ahead. The US 10-year bond yield traded in a 21 basis point range over the month, moving between a high of 2.18% and a low of 1.97% before closing the month at 2.01%. The trading range is smaller than we have seen over recent months however follows on from steady falls in the yield on US Treasury bonds. US 10-year Treasury bonds have fallen from a high point of 3.25% in November last year to below 2% in June 2019.

Corporate Bond Fund Commentary

NZ fixed income assets continued to produce strong returns over June as interest rates continued to move lower in yield. The yield curve flattened with a 0.1% reduction in the yield of short-dated NZ government bonds and longer maturities declining by 0.16%. This fall in yields resulted in longer duration bonds out-performing short duration bonds over the month and also for the past year. A similar result was seen in swap yields and in the yields of non-government bond issues.

Global financial conditions remain accommodative and many Central Banks are looking to provide their economies with more stimulus by cutting short term rates further. The Reserve Bank is also sounding words of warning. In the Official Cash Rate (OCR) commentary the bank stated that" given the weaker global economic outlook and risk of ongoing subdued domestic growth, a lower OCR may be needed over time to continue to meet our objectives". In the same release they also revealed they continue to be concerned about the downside risks around the employment and inflation outlook.

The market is already pricing in rate cuts in New Zealand. We think this is correct however do question if lower rates are going to have the stimulatory effect hoped for by the RBNZ. We do note that proposals to significantly increase capital levels required to be held by NZ banks will make banks stronger but will likely have economic consequences. Perhaps further rate cuts will help minimise the negative impact on the economy if lending rates increase and credit is more difficult to obtain in areas such as the dairy industry as banks adjust their business operations to maintain an acceptable return for their shareholders. This uncertainty and concern is showing up in weak business confidence levels which further reinforces the view that more rate cuts are likely.

Key Fund Facts

Distributions

Retail fund: Calendar quarter

Hedging

All investments will be in New Zealand dollars

Estimated annual fund charges (incl GST)

Retail fund: 1.07%, refer PDS for more details

Buy / Sell spread:	Strategy size	Strategy Launch
0.0% / 0.0%	$13.3m	October 2007

Compliance

The fund complied with its investment mandate and trust deed during the month.

Contact Us

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